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In the United States
Circuit Court of Appeals
For the Ninth Circuit.

THE REPUBLIC SUPPLY COMPANY OF CALIFORNIA, a corporation,
Complainant,

vs.

RICHFIELD OIL COMPANY OF CALIFORNIA, a corporation,
Defendant.

SECURITY-FIRST NATIONAL BANK OF LOS ANGELES, as Trustee, GEORGE ARMSBY, F. S. BAER, HARRY J. BAUER, STANTON GRIFFIS, ROBERT E. HUNTER and ALBERT E. VAN COURT, known and designated as Richfield Bondholders' Committee,
Appellants and Cross-Appellants,

vs.

UNIVERSAL CONSOLIDATED OIL COMPANY, a California Corporation,
Intervener, Appellee and Cross-Appellant,

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, BANK OF AMERICA, a corporation, PAN AMERICAN PETROLEUM COMPANY, a corporation, WILLIAM C. McDUFFIE, as Receiver for Pan American Petroleum Company, a corporation, RICH-

(Continued on Inside Cover.)

BRIEF OF DAVID R. FARIES AS AMICUS CURIAE ON BEHALF OF UNIVERSAL CONSOLIDATED OIL COMPANY.

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FIELD OIL COMPANY OF CALIFORNA, a corporation, UNITED STATES OF AMERICA, THE REPUBLIC SUPPLY COMPANY OF CALIFORNIA, a corporation, CITIES SERVICE COMPANY, a corporation, ROBERT C. ADAMS, THOMAS B. EASTLAND, EDWARD F. HAYES and RICHARD W. MILLAR, known and designated as Pan American Bondholders' Committee, G. PARKER TOMS, ROBERT C. ADAMS, F. S. BAER, ROBERT E. HUNTER, HENRY S. McKEE and RICHARD W. MILLAR, known and designated as Richfield Pan American Reorganization Committee, WILLIAM C. McDUFFIE, as Receiver of Richfield Oil Company of California, SECURITY-FIRST NATIONAL BANK OF LOS ANGELES, a national banking association, PACIFIC AMERICAN COMPANY, a corporation, AMERICAN COMPANY, a corporation, MANUFACTURERS TRUST COMPANY OF NEW YORK, a corporation, CITIZENS NATIONAL TRUST & SAVINGS BANK OF LOS ANGELES, a national banking association, FIRST NATIONAL BANK AND TRUST COMPANY OF SEATTLE, a national banking association, CONTINENTAL ILLINOIS BANK AND TRUST COMPANY, a corporation, THE FIRST NATIONAL BANK OF CHICAGO, a national banking association, CHEMICAL NATIONAL BANK AND TRUST COMPANY, a national banking association, and CALIFORNIA BANK, a corporation, M. W. LOWERY, HENRY S. McKEE, O. C. FIELD, R. R. TEMPLETON, known and designated as Richfield Unsecured Creditors' Committee,

Appellees.

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BRIEF OF DAVID R. FARIES AS AMICUS CURIAE ON BEHALF OF UNIVERSAL CONSOLIDATED OIL COMPANY.

INTRODUCTION.

This brief is filed by the undersigned counsel as *amicus curiae* on behalf of Universal Consolidated Oil Company pursuant to an order of this Honorable Court, made in the above entitled matter on the 25th day of April, 1935.

We are filing this brief in the hope that some of the matters discussed herein may be of assistance to this Honorable Court in its consideration of the matters raised in these consolidated appeals. We are also particularly interested in the determination of these questions in view of the fact that we represent Mr. R. D. Miller, one of the minority stockholders of Universal Consolidated Oil Company (hereinafter referred to as Universal).

Subsequent to the confirmation of the report of the Special Master by the learned Trial Court, Mr. Miller, as a minority stockholder of Universal, after discussing the matter with his personal counsel, felt that an appeal should be taken to this Honorable Court. He, therefore, in writing, requested the Board of Directors of Universal Consolidated Oil Company to authorize such an appeal, and upon their refusal so to do, filed his petition with the learned Trial Court wherein it was prayed that he, as a stockholder, be allowed to prepare an appeal on behalf of Universal. In that petition, Mr. Miller alleged, and, at the hearing on the same, introduced evidence to the effect that five out of the nine directors of Universal were controlled by Richfield Oil Company of California (hereinafter referred to as Richfield) or its receiver. This petition was denied and Mr. Miller thereupon proceeded with

an appeal to this Honorable Court from the order denying him leave to intervene.

In the meantime, Universal and Security-First National Bank of Los Angeles (hereinafter referred to as Security Bank), proceeded to take appeals to this Honorable Court from the original order of the trial court confirming the report of the Special Master and overruling exceptions thereto. Consequently, a stipulation, or "Agreement Dismissing Appeal Pursuant to Rule (20 C. C. A. 9)" as it was called, was executed by counsel for Universal, counsel for Security Bank, as trustee, counsel for William C. McDuffy, as Receiver of Richfield, and the undersigned, as counsel for Mr. Miller. The original of that stipulation is on file herein. It contains the agreement, in brief, that the appeal of Mr. Miller should be dismissed, that he in return should be given at least ten days' notice of any motion or agreement to dismiss the appeals which are now being presented to this Honorable Court, and further, that his counsel should have leave to file a brief as *amicus curiae* on behalf of Universal Consolidated Oil Company.

Pursuant to this stipulation this Honorable Court in the October Term of 1934, on Thursday, the 25th day of April, 1935, with the Honorable Curtis D. Wilbur, Senior Circuit Judge presiding, and the Honorable William Denman, Circuit Judge, and the Honorable Clifton Mathews, Circuit Judge, also present, made the following order in this cause:

> "Upon consideration of the certificate of the Clerk of the District Court herein, and stipulation of counsel for respective parties, and good cause therefor appearing, IT IS ORDERED that the appeal of R. D. Miller herein be, and hereby is dismissed, without costs to any party, that a decree of dismissal be filed and entered accordingly, and the mandate of this

court as to appeal of R. D. Miller be issued forthwith.

"And, pursuant to said stipulation, leave is hereby granted to David R. Faries to file a brief in this cause on behalf of Universal Consolidated Oil Company as *Amicus Curiae.*"

STATEMENT OF THE CASE.

In this brief we will not burden the court with any detailed statement of the case in addition to that contained in the brief of the cross-appellant Universal. In view of the concession on the part of all parties that there was a misappropriation of Universal funds by Richfield, and that such misappropriation constituted Richfield the trustee of a constructive trust of which Universal was the beneficiary, the only question left for determination by this Honorable Court concerns the sufficiency and method of the tracing of these trust funds into property purchased by Richfield. [Tr. pp. 96 and 97.]

The misappropriated funds, as is more fully set forth in Universal's statement (Universal's Brief pp. 7-11), were deposited in the bank account of Richfield. In the process of tracing these funds through this bank account, it became necessary to determine the lowest bank balance as a result of familiar rules of tracing into mixed-money funds. Three different methods of calculating the lowest bank balance were considered: (One) The method of taking the lowest daily closing balance on the bank's record. (Two) The method of taking the lowest posted balance on the books of the bank of any given date. (Three) The method of taking the opening balance of a particular day, and arbitrarily deducting therefrom all of the withdrawals made on that day, refusing to credit

any of the deposits for the day, and considering that remainder as the lowest balance. [Tr. p. 147.]

The third method was the one adopted by the Special Master, and confirmed by the learned Trial Court. It resulted in Universal being given a trust lien of $403,-993.92 and a general claim of $779,154.31. It is the contention of Universal and of the undersigned *amicus curiae* that the adoption of this method was erroneous. We will endeavor to demonstrate that method number one, to-wit, the lowest daily closing balance on the bank's record is the only fair method of ascertaining the lowest intermediate balance. This would entitle Universal to a trust lien of $849,864.25, and a general creditor's claim of $333,-283.98. The first part of our argument will be in support of this contention.

The Special Master, after arriving at what he considered to be the correct lowest intermediate balance, proceeded to hold that sum had been traced into certain specific properties purchased by Richfield with funds withdrawn from its bank account, although the remainder of the bank account was thereafter dissipated. The appellant Security Bank as trustee, in its appeal contends that this tracing of trust moneys from the bank account into certain properties purchased and retained by Richfield was not supported by the evidence. In support of that contention counsel for Security Bank argue that the doctrine of the English case of *In re Oatway*, 2 Chancery Division 356, has been repudiated in the Federal Courts.

It is our contention that the doctrine of *In re Oatway* does apply to this particular case, and in this respect the reasoning of the Special Master and its confirmation by the learned Trial Court should be confirmed. The latter portion of our argument will be addressed to this point.

SPECIFICATION OF ERRORS RELIED UPON.

In this brief, as *amicus curiae* on behalf of Universal, we will rely upon the same specification of errors set forth in Universal's brief on page 15 thereof. They are as follows:

1. The District Court erred in approving and confirming the finding of fact and/or conclusion of law of the Special Master that said intervenor was entitled only to a trust imposed upon certain designated parcels, to-wit: Parcels 1 to 8, inclusive, in the total sum of $403,993.92. [Assignment of Errors, 2, 4; Tr. pp. 266, 267.]

2. The District Court erred in approving and confirming the finding of fact and/or conclusion of law of said Special Master limiting the recovery of Universal to the low bank balance theory adopted by said Special Master. [Assignment of Errors, 6, 9, 11; Tr. pp. 268, 269.]

3. The District Court erred in failing to decree and enforce in favor of Universal a trust on Parcels 1 to 9, inclusive, in the aggregate amount of $849,-864.25. [Assignment of Errors, 5, 12, 13; Tr. pp. 268, 270, 271.]

4. The District Court erred in failing to allow intervener a trust based upon the closing bank balance at the end of each day in the bank account of Richfield. [Assignment of Errors, 7, 8, 10; Tr. p. 269.]

ARGUMENT.

I.

The Closing Balances of the Particular Days in Question Should Be Used in Determining the Amount of the Trust Lien.

It will be admitted that the burden of proof is upon the beneficiary of a constructive trust to trace his misappropriated funds into specific property before he can claim that property as his own, or before he can assert a lien thereon. In this case, Universal admittedly occupies the position of the beneficiary attempting to establish a preferred claim, and we do not question the fact that Universal must sustain this burden of proof. We likewise concede for the purposes of this case, that when misappropriated moneys are deposited in a fluctuating fund, which likewise contains moneys of a trustee, the trust lien of the beneficiary is limited to the lowest intermediate balance in that fund prior to the date of any identified purchase out of that fund.

We respectfully submit, therefore, that the question presented to us here is what constitutes sufficient evidence to establish a *prima facie* case as to the lowest intermediate bank balance in the bank account of Richfield. We believe that the daily closing balances do establish such a *prima facie* case.

We do not contend that that showing relieves Universal of the burden of proof, but we respectfully maintain that unless Richfield, as the constructive trustee, can by competent evidence show affirmatively that some other figure represents the lowest intermediate balance, the burden of proof has been satisfied. With this principle in mind, let us examine the evidence introduced before the Special Master upon this point.

Lowest Daily Closing Balance Method.

First, it was shown by Universal that the misappropriated moneys were deposited in Richfield's bank account in Security Bank, and there commingled with moneys of Richfield. It was also shown that the properties and assets upon which a trust lien is claimed were paid for in whole or in part with checks from that bank account. [Tr. p. 97.]

It appeared that this account had been dissipated a week before the appointment of the Receiver for Richfield. Universal therefore proceeded to show the lowest daily closing balances between the taking of Universal funds and withdrawals from the bank account which were converted into assets claimed by Universal. These daily closing balances reflected all checks charged against the bank account and all deposits credited to it during the day. [Tr. p. 98.] These balances are set forth in Schedule "A", column No. 3, transcript p. 102 through p. 105.

We believe that a thorough discussion and examination of the evidence will show that these daily closing balances constitute the only competent evidence on this point. These daily closing balances are accepted in ordinary business practice as the proper method of determining the balances in a bank account. In fact, the Security Bank, apparently considered the daily bank balance as the only true balance, because, although by their system of bookkeeping they recorded certain trial posted balances throughout the day, those posted balances were never given to the depositor when he requested the amount of his balance. [Tr. p. 99.] It is not only the custom but it is reasonable that business practice should adopt the closing balance as the only true balance because it is the balance

at the end of the day, when *all* withdrawals have been charged against the account and *all* deposits have been credited to that account. It not only seems self-evident that that balance should be used, but a Court of Equity is entitled to rely upon modern business practices in matters of this kind.

Schumacher v. Harriet (C. C. A. 4th, 1931), 52 Fed. 2d 817, 820, 821, contains a good statement of this rule:

> "The duty of courts is to apply the principles of law and equity to the conditions of our changing life; and we have no doubt that in view of modern banking practices the modern but well settled doctrine of tracing trust funds is applicable to the situation here disclosed."

The case of *Walker v. Holden,* 6 Fed. Sup. 262, 265, a 1934 decision of the District Court of Illinois is to the same effect.

At any rate, the evidence of Universal that its misappropriated funds had been deposited in Richfield's bank account and that the books of Security Bank disclosed these certain lowest daily closing balances, prior to the invested withdrawals, without other evidence, clearly established a *prima facie* case, and therefore satisfied the burden of proof. If that is true, that state of the evidence then left the case in a position where it was incumbent upon Richfield to introduce evidence which would show that some other balance should be adopted, or concede that Universal had traced its funds to that point. This conclusion is, we believe, amply supported by the following authorities.

In *Meyers v. Baylor,* a Texas case, found in 6 S. W. 2d 393, cited at page 27 of the appellant Universal's

brief, it appeared that Meyers had embezzled the University's money and deposited it in his own bank account. He then drew upon the mixed fund and purchased certain real property. In holding that the University was entitled to impose a trust upon that property, the court stated the rule as follows:

> "It is quite true that the burden of proof was upon plaintiff to establish the trust, but when proof of the fiduciary relationship of the parties was made, the betrayal of the trust, and probable amount of the embezzlement shown, a *prima facie* case was presented, and the burden was then on Meyers to show, if he could, that his money, and not that of the plaintiff, paid for the properties in whole or in part.
>
> "Meyers was in possession of the exact facts, and it was his duty to reveal the entire truth. As he did not testify and made no explanation of this matter, every intendment is against him."

In the instant case, Richfield, the misappropriating trustee, and its depositary, Security Bank, were in possession of the facts, as was the embezzler Meyers in the cited case. Universal proved the fiduciary relationship, the betrayal of the trust, the amount of the embezzlement, and showed from the books of the bank the closing balances for the days in question. It had clearly sustained its burden of proof, and to paraphrase the Texas court, if Richfield or the bank did not explain the matter further, every intendment should be against them.

In addition to that case cited in Universal's brief, we would like to call the attention of this Honorable Court to the following additional authorities.

> *Grand Forks Co. v. Baird,* 54 N. D. 315, 209 N. W. 782 (1926).

Here an action was brought by a county against the receiver of a bank to impress a trust arising out of the wrongful deposit of county funds. A judgment was entered in favor of the county to the extent of the lowest amount in the bank between the deposit and the receivership. In affirming this judgment the court said:

> "The judgment is limited to the cash assets. If they were ever lower than at the time the bank was closed, such fact does not appear; but we are of the opinion that, in the absence of evidence, it should be presumed that they were never less than at the time of closing; also, that it is incumbent on the defendant to offer evidence to the contrary." (209 N. W. at 783.)
>
> *Farmers Bank v. Bailey,* 221 Ky. 55, 297 S. W. 938 (1927).

In this case the bank wrongfully sold certain bonds and mingled the proceeds therefrom with its own funds. Apparently no evidence on the question of tracing was offered other than a showing as to the amount of the closing balance.

In considering this point, the court said:

> "The amount of cash on hand at periods prior to the closing of the bank is not shown. It does not appear that the cash balance was ever less than the balance on hand when the bank closed. As the proceeds of the bank were traced into the cash of the bank, and the presumption is that the bank discharged its own obligations from its own funds, we are constrained to the view that the bondholders have a preferred claim on the cash on hand when the banking commissioner took charge."
>
> *Hawaiian Pineapple Co. v. Browne,* 69 Mont. 140, 220 Pac. 1114 (1923).

In this case involving the tracing of the proceeds of a draft into the collecting bank which became insolvent and was placed in receivership before the avails were forwarded to the plaintiff, the court held that a trust relationship had been established and discussed the matter of tracing as follows:

> ". . . counsel for defendant says, correctly, . . . the preference may not extend above the amount of the lowest balance on hand in the collecting bank between the time of making the collection and its enforced closing. So far as we are appraised by the record, the sum of $1801.62 was the lowest amount of cash in the bank at any time after the collection was made. *If the contrary is true, the facts were in the receiver's possession, but he did not disclose them.*" (These and all other italics are ours unless otherwise noted.)
>
> *Israel v. Woodruff*, 299 Fed. 454, 457 (C. C. A. 2d) (1924).

The Circuit Court of Appeals, in considering the question now before us stated the rule as follows:

> "If one mixes trust funds with his own, the same will be treated as a trust property, except so far as he may be able to distinguish what is his own."
>
> *National Bank v. Life Insurance Co.*, 104 U. S. 67, 26 L. Ed. 693 (1881).

In this case, involving the tracing of trust funds into a bank account, the rule was stated in the head note written by Mr Justice Mathews, the writer of the opinion, as follows:

> "That, so long as trust property can be traced and followed into other property into which it has been

converted, the latter remains subject to the trust, and that if a man mixes trust funds with his own, the whole will be treated as the trust property, except so far as he may be able to distinguish what is his own, are established doctrines of equity and apply in every case of a trust relation, and to moneys deposited in a bank account, and the debt thereby created, as well as to every other description of property."

In re J. M. Acheson Co., 170 Fed. 427, 429 (C. C. A. 9) (1909).

This Honorable Court then consisting of Gilbert and Ross, Circuit Court Judges, and Hunt, District Judge, speaking through Hunt, J., upon considering the sufficiency of a bill in equity to establish a trust, stated the doctrine of this Circuit as to questions of proof in the establishment of trusts in mixed money funds as follows:

"In carrying out the rule, when it comes to proof, the owner must assume the burden of ascertaining and tracing the trust funds, showing that the assets which have come into the hands of the trustee have been directly added to or benefited by an amount of money realized from the sales of the specific goods held in trust; and recovery is limited to the extent of this increase or benefit. City Bank of Hopkinsville v. Blackmore, 75 Fed. 771, 21 C. C. A. 514; Cushman v. Goodwin, 95 Me. 353, 50 Atl. 50. If, however, he succeeds in making requisite proof, *it then devolves upon the bankrupt, or the trustee who takes the property of the bankrupt in the same relation that it was held by the bankrupt, to distinguish between what is his and that of the cestui que trust.* Smith v. Mottley, 150 Fed. 266, 80 C. C. A. 154;

Smith v. Township of Au Gres, 150 Fed. 257, 80 C. C. A. 145, 9 L. R. A. (N. S.) 876."

Smith v. Mottley, 150 Fed. 266, 268 (C. C. A. 6th) (1906).

This case involved the establishment of a trust upon the assets of a bank which had wrongfully received the beneficiary's money some ten days prior to a general assignment for the benefit of creditors. Apparently the proof extended no further than that, and after holding that a trust relationship existed, the Circuit Court of Appeals for the Sixth Circuit discussed the matter as follows:

> "In the absence of any proof to the contrary, the reception of the funds being so near to the assignment by the bank, it may be presumed that the assets which came to the hands of the trustee were augmented by the appropriation of the proceeds of the check. *If it were not so, the burden was on the trustee to prove it; or, if not augmented to the whole amount of the check, then to what amount they had been lost out.* It is shown that three times the amount of this fund remained in the bank to the time of the assignment and came to the trustee. The burden of showing that his property has been wrongfully mingled in a mass of the property of the wrongdoer is upon the owner; but, when this is done, the burden shifts to the wrongdoer. It is for him to distinguish between his own property and that of the innocent party. Smith, Trustee, v. Township of Au Gres, *supra;* Hart v. Ten Eyck, 2 Johns. Ch. 108; Starr v. Winegar, 3 Hun. (N. Y.) 49; Stephenson v. Little, 10 Mich. 441, 450; Ryder v. Hathaway, 21 Pick. (Mass.) 298, 306; Seavey v. Dearborn, 19 N. H. 361; Robinson v. Holt, 39 N. H. 557, 75 Am.

Dec. 233; Janes v. Burnet, 20 N. J. Law, 635, 642; Kreuzer v. Cooney, 45 Md. 591; Elgin Bank v. Schween, 127 Ill. 580, 20 N. E. 681, 11 Am. St. Rep. 174; Mayer v. Wilkins, 37 Fla. 244, 19 South. 632; Weil v. Silverstone, 6 Bush. (Ky.) 698; Stuart v. Phelps, 39 Iowa 20; Loomis v. Green, 7 Me. 386; Dillingham v. Smith, 30 Me. 383; Lehman v. Kelly, 68 Ala. 192; Franklin v. Gumersell, 9 Mo. App. 90."

It seems self-evident in the light of these cases, and the common business practice of accepting daily closing bank balances as the true balances of an account, that if the evidence with respect to the bank account had stopped at this point, Universal would have undoubtedly sustained its burden of proof. If the only evidence concerning the status of the bank account were these daily closing balances of the Security Bank, no one could seriously contend that the lowest intermediate balances were not thereby established. Certain other evidence, however, was introduced concerning the status of the account. Let us now examine it to see what affect it has upon the daily closing balances.

Lowest Daily Posted Balance Method.

On pages 99 and 100 of the transcript it is shown that evidence was introduced to the effect that Security Bank, as a result of its bookkeeping methods, obtained certain posted balances throughout the day. These posted balances resulted from the fact that customers' accounts were kept on bookkeeping machines. The customers' ledger sheets were inserted in those machines for the purpose of posting checks or deposits, and before the sheet could be extracted from the machine it was necessary to place the balance on the ledger sheet. The evidence disclosed, how-

ever, that these posted balances which were obtained merely for purposes of convenience did not disclose the actual status of the account. This fact is, perhaps, best summarized in the words of the transcript on page 100.

> "The balances that appear during the course of the day do not necessarily show all of the checks on that account that have come to the bank, or all of the deposits to that account that have been made up to the time that balance appeared, nor do they show the time of day when such balances were made, nor do they show the order in which deposits were made or the order in which checks are presented during the course of the day. It would be possible for other checks against the account to have been presented for payment and other deposits to have been made to the account prior to the time when the balance in question was taken. But those checks and deposits would not be reflected in the particular balance either because they had not been passed on to the bookkeeper for posting or because they were not included in the particular group of checks upon which the bookkeeper was working at the moment."

A mere reading of this agreed statement of the evidence introduced at the hearing before the Master would seem to us to conclusively demonstrate that the evidence of the intermediate posted balances could not by the wildest stretch of the imagination be considered as refuting the *prima facie* case established by Universal when the daily closing balances were introduced in evidence. In this connection, we believe it will be helpful to examine the reasoning of the Special Master with respect to this evidence.

An examination of the Master's report shows that he realized that the so-called posted balances did not reflect

the true state of an account. In a part of his report appearing on page 149 of the transcript, he says in referring to the bookkeeper's practice:

> "The balance he strikes does not necessarily represent the actual balance of all deposits and checks at the time. It represents only the balance of those checks and deposits which are then posted. The balance taken periodically during the day, as aforesaid, does not necessarily give a true picture of the low balance for the day, because it ignores the unposted checks."

Again, in that portion of his report appearing on page 150 of the transcript, he says:

> "The intermediate balances are merely working balances, so that the bookkeepers can go ahead with their work. *The only balance that the bank will recognize as really showing the state of the account is the one at the close of the day.*"

As a result of this reasoning, therefore, the Special Master rejected the so-called intermediate posted balances, and although he realized, as the above quotation shows, that the only balance the bank recognizes as really showing the state of the bank account is the one at the close of the day, he did not take the next logical step and adopt that closing bank balance as the true one. He proceeded instead, to discuss the rule that the burden of proof rests upon the *cestui* attempting to establish a trust lien. This then led him to the following conclusion

> "This burden relates to the actual, not the presumptive, balance. The actual order of withdrawals and deposits in point of time is therefore material. *If the postings faithfully observe that order, actual balances will result.* But they do not observe it in

the present case, and it is necessary therefore to seek the fact elsewhere." [Tr. p. 153.]

The only difficulty we respectfully submit with the Master's conclusion is that there was no definite evidence in the record showing that the closing balance of the day did not represent the true status of the account. The only evidence other than the closing balances was with respect to the intermediate posted balances, and these the Master himself admitted did not disclose the true status of the account. They, therefore, did not in any way refute the *prima facie* case established by the daily closing balances. The learned Master, however, apparently reached his conclusion, not as a result of any evidence, but as a result of the merest surmise. In referring to the system of bookkeeping maintained by the Security Bank, he says:

> "Under this system, it would be possible for an opening balance to show $100,000.00 and the closing balance to show $100,000.00, and yet in the meantime checks might have been entered on the account which would completely wipe out the balance at noon and then other deposits in the afternoon might be made which would bring it up to a closing balance of $100,000.00. *There is no way under the system used by said bank of telling whether that actually happened on a particular day or not.*" [Tr. p. 148.]

The Master's very statement of the proposition disclosed that there was no evidence introduced to the effect that some withdrawal had reduced the account below the lowest daily closing balances. In fact, he says:

> *"There is no way under the system used by said bank of telling whether that actually happened on a particular day or not."*

If that is true, there obviously was no evidence in the record to refute the *prima facie* case established by Universal, and the daily closing balances should have been accepted by the Special Master, and the Court in the same manner as they were accepted by the Security Bank as the only true showing of the state of a customer's account.

Method Adopted by Special Master.

After reaching the conclusion that the daily closing balances should be rejected because of the bare possibility, unsupported by any evidence, that some withdrawal might have reduced the bank account to a lower figure, the Master adopts an entirely different method of ascertaining the lowest intermediate bank balance. This method consisted of first taking the opening balance of a particular day, assuming, without any evidence to that effect, that all withdrawals were made on that day before any deposits were made, and as a result arbitrarily deducting all withdrawals from that opening balance while completely disregarding any deposits made during the day. This resulted in a complete disregard of the actual facts of the case, and a holding of Universal's trust lien to the barest minimum. The practical result was that under this method adopted by the Master, Universal was only entitled to a trust lien of $403,993.92, instead of a trust line of $849,864.25 disclosed by the daily closing balances.

It is true that the rule adopted by the Special Master holds the defrauded Universal to a very minimum of recovery, and protects the defaulting trustee Richfield from any possibility of an excessive trust lien. This does not, however, we respectfully suggest, in the absence of clear affirmative evidence demonstrating that this result must be reached, seem to us to be equity. Certainly Universal

and its approximately 2800 defrauded minority stockholders deserve greater consideration from a court of equity than Richfield or Security Bank, the trustee of its bond indenture. The cases we have cited indicate that the defrauded *cestui* has met his burden of proof when he traces his money into a mixed fund and shows a *prima facie* low balance. That is his *prima facie* case. It is then incumbent upon the wrongdoer to show by affirmative evidence that what appears to be *prima facie* the lowest balance, is, in fact, not correct. The Master, however, relieves the wrongdoer of this responsibility, disregards the *prima facie* case of the lowest daily closing balances and holds Universal to a minimum entirely unsupported by the evidence.

In illustration of the effect of the rule adopted by the Master upon Universal, let us assume that the opening balance was $1,000.00, immediately thereafter a deposit of $500.00 was made, and then, just before closing, a $200.00 check was paid. It certainly could not be contended that a low balance of $800.00 occurred at any time that day, yet that would be exactly the conclusion reached by the Special Master under his rule.

This rule is not supported by any authority and is certainly not supported by business practice. When a bank computes the interest on a customer's balance, it uses the closing balance for the day. When the bank estimates the right of a customer to borrow against his account, the daily closing balance is always used. If a bank should follow the rule adopted by the Special Master, in answering a call of the Comptroller of the Currency for a statement, it would certainly be liable for the falsification of such a statement. Undoubtedly, if a bank followed the

Master's rule in preparing monthly statements and subtracted all withdrawals, but refused to credit deposits, a customer would strongly and properly object.

Courts of equity have always recognized the high equity of a defrauded *cestui* and his right to claim his money or property stolen by the faithless trustee. As business methods became more complex, the leading cases of *In re Hallett* and *In re Oatway,* both of which are discussed under the next point in this brief, considered the difficulties attendant upon tracing trust moneys into mixed money funds. In the present instance, the complexity of the bank accounts, and the bookkeeping methods of Security Bank should not be allowed to defeat the equitable claims of Universal.

Since the days of the Mosaic Law, courts have recognized the superior right of the victim to recover his goods, or money, from the hands of the thief.

> "If the theft be certainly found in his hand, he shall restore double."—*Exodus* 22-4.

This rule is particularly applicable to this case because it has been found and commented upon by the Master that Richfield conspired to acquire the stock of Universal because of the $1,700,000.00 quickly available to Universal's treasury. Richfield realized that this cash would permit it to pay for a controlling interest in Universal, out of Universal's own funds, and this is precisely the program Richfield followed. The burden of this stupendous theft fell heavily upon the minority stockholders of

Universal, and justice and equity can only be done to them by restoring this misappropriated money or its product. The fact that Security Bank does not strike correct balances on its bank accounts until the end of each day, should not in these modern times prevent a court of equity from restoring to Universal's minority stockholders that which was stolen. Certainly, the fact that the stolen funds were deposited by the wrongdoer in such a bank account, should not prevent Universal and its minority stockholders from relying upon the daily closing balances of that bank in the absence of clear affirmative proof refuting that showing.

The Security Bank relies heavily upon the cases of *In re Brown,* 193 F. 24 and *Schuyler v. Littlefield,* 232 U. S. 707, 58 L. ed. 806, in an attempt to limit Universal to the trust lien allowed by the Master's theory. It must be remembered, however, that although there was language in the *Brown* case indicating in that instance the opening and closing balances might not be sufficient evidence, that language must be considered in the light of the facts of that case. That was not a case where the plaintiff clearly had an equity superior to all others. There were other defrauded *cestuis* whose equities stood as high as that plaintiff, and such a situation might easily, whether rightly or not, cause a court to consider daily closing balances insufficient to raise one claimant higher than those with equal equities.

In the present instance, we need not be confused by any claim of equal equities. We have only the predomi-

nate superior equity of the minority stockholders of Universal to consider. Furthermore, in the *Brown* case, it was shown that a check of sufficient size to completely wipe out the opening balance was certified early in the day. That situation does not exist here. There is no such affirmative evidence present to refute the daily closing balances. We have here only the mere surmise of the Special Master that a large withdrawal might have been made early some day.

As a matter of fact, when the Supreme Court considered the claims arising out of the failure of Brown & Company in the companion case of *Schuyler v. Littlefield,* it clearly recognized the propriety of using closing balances. This is disclosed by the following language appearing at the bottom of page 711 and at the top of page 712 of the Official Report:

> "If the trust fund of $9,600, was included in the check for $266,600, then it was dissipated except to the extent of $6,180.17, *which was the sum left to Brown & Company's Credit at the close of business on August 24th.* And inasmuch as all of that balance was paid out early the next day, the trust fund was thereby wholly dissipated so far as the bank account was concerned."

Before leaving this point, it should be pointed out that the Security Bank as trustee does not have an equity which can in any way compare with Universal and its minority stockholders. The Security Bank, as trustee of

the Richfield bond indenture, is representing bond holders who loaned their money to the faithless trustee Richfield, and took back a mortgage upon its properties. It is elementary, and the Master held, that the Security Bank must take title subject to the preferred trust lien of Universal. This is true because in equity, Richfield never obtained title to the moneys stolen from Universal or the goods purchased with those ill-gotten gains. Consequently, the Security Bank, which with its bondholders dealt in a contractual way with Richfield, could not obtain title by virtue of its mortgage to property which did not belong to Richfield. Security Bank and the bondholders dealt with Richfield at arm's length and with their eyes wide open. The minority stockholders of Universal were kept in ignorance of the true state of affairs and lost moneys unknowingly to a thief.

The most that can be said for the evidence introduced to attack the *prima facie* case established by the daily closing balances, is that it disclosed that Security Bank used a method of bookkeeping which did not disclose the true state of a customer's account until the end of the day. The most that can be said for the rule adopted by the Master, is that it is based upon the merest surmise, and could be true only by the most improbable happenstance. In brief, there is not one bit of affirmative evidence in the record which in any way refutes the *prima facie* case of the daily closing balances, the balances which the Master and the Security Bank admit to be the only ones that truly disclose the state of a customer's account.

II.

Where a Trustee Commingles Trust Funds With His Own, Invests a Portion of Such Funds in Property Which He Retains, and Dissipates the Remainder, the Rule in the Federal Courts Allows the Cestui a Lien Upon the Property Retained.

The above rule was established as the law in England by the well known case of *In re Oatway* (*Hertsley v. Oatway*) (1903), 2 Ch. D. 356.

There the trustee deposited trust moneys in his own bank account. He then withdrew a portion of the commingled moneys and invested the same in stock, taking title thereto in his own name, later dissipating the remainder of the fund in his bank account. In a creditors' action for the administration of the estate of the trustee (Mr. Oatway) the question arose as to the title to the proceeds derived from a sale of the stock. Joyce, J., held that the proceeds of the stock belonged to the beneficiaries, and stated:

> "* * * It is, in my opinion, equally clear that when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, the rest of the balance having been afterwards dissipated by him, he cannot maintain that the investment which remains represents his own money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust."

A review of the Federal cases reveals that the same rule governs in the Federal courts.

One of the earliest Federal cases establishing the rule of *Re Oatway* as the rule in the Federal courts is *Primeau v. Granfield,* 184 Fed. 480 (D. C. N. Y.) (1911).

In this case the plaintiff (Primeau) remitted moneys from the East to the defendant (Granfield) in Colorado, to be invested in mining properties. The defendant deposited the funds in his own bank account, and later paid money therefrom into the sinking of a mining shaft and the opening of a lease. Thereafter he dissipated the remainder of the account. It was held that the plaintiff was "entitled to that portion of the value of the ore *in situ,* as is represented by his contribution to the total expenses of working, plus the total rentals or royalties paid the lessor." (184 Fed. at 488.) Mr. Justice Learned Hand, then sitting upon the District Court bench, in a well reasoned opinion, expressly applied the rule of *In re Oatway:*

> "A more difficult question, because it is without authority, arises in ascertaining what part of the withdrawals shall be deemed to have been Primeau's money. I shall consider each bank account as if it were a separate fund, because the parties consent to that disposition. No one disputes that, if the interlocutory decree be right, then some of Primeau's money went into the several bank accounts. Primeau by that mingling got more than a lien, and got the option either to claim a lien or to claim that he was a co-owner in the fund. The language about presumed intent in Knatchbull v. Hallett, *supra,* which Sir George Jessel laid down with his customary vigor, was merely a way of giving an explanation by a fiction of the right of the beneficiary to elect to regard his right as a lien. That it is a fiction appears clearly enough in this case where Granfield could have had no intention about the investments as he meant to use all the money for himself anyway. To say that in such a case he will be 'presumed' to intend to take his own money out first is merely a

disingenuous way common enough, to avoid laying down a rule upon the matter. *This fiction in Re Oatway (1903), 2 Ch. Div. 356, would have brought the usual injustice which fictions do bring, when pressed logically to their conclusion. Logically the trustee's widow, in that case, was quite right in claiming the first withdrawal, although the trustee had invested it profitably, and had subsequently wasted all of the fund which had remained in the bank. That was, of course, too much for the sense of justice of the court which awarded to the wronged beneficiary the investment, intimating that the rule in Knatchbull v. Hallett, supra, applied only where the withdrawals were actually spent and disappeared.* If to that rule be added the qualification that if the first withdrawals be invested in losing ventures, then the beneficiary is to have a lien, if he likes, till he uses up that whole investment, and then may elect to fall back for the balance upon the original mixed account from which the withdrawal was made, there is no objections, but it is a very clumsy way of saying that he may elect to accept the investment if he likes, or to reject it. The last is the only rule which will preserve to the beneficiary the option which he has when the investment is made wholly with his money. Suppose, as here, that the trustee deposits the money with his own in a bank. That is an investment. We call it a deposit, but we all know that it is only a chose in action. The beneficiary has the right at his election either to become a part owner in this chose in action, or to keep a lien upon it. Suppose he chooses to be a part owner; then, when part of it is released by payment, he is likewise a proportionate co-owner in the money paid. If that money is in turn invested he is a proportionate co-owner in that new investment, and there is no ground why as to

that investment likewise he should not have, at his election, the right to become a lienor *pro tanto*. Sir George Jessel's dictum in his judgment in Knatchbull v. Hallett at page 710 did not deny this, if the words are nicely observed. He says that in the case of a purchase with a mixed fund 'the *cestui que* trust, or beneficial owner, can no longer elect to take the property, because it is no longer bought with the trust money purely and simply.' No one can dissent from that statement of the law. Then he at once follows it by saying that he does have a charge, which, likewise, no one disputes; but he nowhere says that he has only a charge, and may not have *pro tanto* an ownership. Two chancellors, Lord Brougham and Lord Cottenham, had previously said that the beneficiary might have such an ownership, and later in *Re* Oatway it became apparent that, if not, then very great wrong could be done. Sir George Jessel was a very great equity judge, and no one should lightly differ with him, but there is no reason in this case to impute to him anything of the kind here suggested, or to press the fiction of a presumed intent to a conclusion which is out of harmony with the rights of a beneficiary in the analogous case where there has been no mingling of the funds." (184 Fed. at 484, 485.)"

This decision was reversed on appeal, but only upon the ground that both parties came into court with unclean hands (which point was there raised for the first time), the Circuit Court of Appeals making no mention of the point with which we are here concerned. (*Primeau v. Granfield,* 193 Fed. 911 (C. C. A. 2); *cert.* den. 225 U. S. 708, 56 Law. Ed. 1267.)

It is to be noted that in the *Primeau* case, Mr. Justice Hand went even further than the position we are asking this court to adopt in the present case. Judge Hand gave the beneficiary not merely a lien or charge upon the property retained by the wrongdoer, but a proportionate or *pro rata* share in the profits.

This is not the only time Judge Learned Hand has expressed an opinion in favor of the adoption of the rule of *In re Oatway,* by the Federal courts. In *In re O. A. Brown & Co.,* 189 Fed. 433 (D. C. N. Y.) (1911), where trust funds were mingled with the trustee's own monies, and then monies were taken out of the commingled mass and placed in stocks, Mr. Justice Hand held that the beneficiary could not follow its trust funds into the stocks because "claimants . . . failed to prove that at the time of the alleged investments any of their money remained in the account, and that is a necessary step in tracing their money into any particular part of the estate." (189 Fed. at 438.) What the holding of Judge Hand would have been if the claimants had proved, as Universal has in the present case, that at the time of the alleged investments, their money remained in the account, is shown by the following quotation from the *Brown* case approving the doctrine of *In re Oatway:*

> "I need not therefore consider whether, for the purposes of establishing a lien, the beneficiary may select any earlier withdrawal which went into an investment and which has been preserved. If the general mixed fund has been wholly dissipated, it has been held that he may do so (*Re* Oatway, 1903, 2 Ch. Div. 356), and that Knatchbull v. Hallett, *supra,* does not limit him to a lien only where the result will be to prevent his following his money." (189 Fed. at 439.)

The *Re Oatway* doctrine was further and conclusively entrenched as the rule in the Federal courts by three Circuit Court of Appeals cases.

Brennan v. Tillinghast, 201 Fed. 609 (C. C. A. 6) (1913);

In re Pacat Finance Corporation, 27 Fed. (2d) 810 (C. C. A. 2) (1928);

Fiman v. State of South Dakota, 29 Fed. (2d) 776 (C. C. A. 8) (1928).

In *Brennan v. Tillinghast, supra,* the National Bank of Ironwood received, knowing itself to be insolvent, certain stock of the plaintiff as collateral security for his note. A number of the shares of this stock were wrongfully sold and the proceeds amounting to $3,558.75 were deposited on May 1, by the Ironwood Bank, in its account with a Duluth Bank. Between May 1 and May 8, the Ironwood Bank drew drafts upon the Duluth Bank, receiving from the purchaser cash which was deposited in the Ironwood Bank's own vaults. *From the time of the deposit on May 1 (in the Duluth Bank) until the withdrawal (from the Duluth Bank) the Ironwood Bank's account with the Duluth Bank exceeded the amount of the proceeds derived from the wrongful sale of plaintiff's stock.* Upon the Ironwood Bank closing its doors, the plaintiff asked for a preferential claim. The lower court gave the plaintiff a preferential claim for the amount of the stock (less the amount of plaintiff's note to the Ironwood Bank and the amount of an overdraft). On appeal by the receiver of the Ironwood Bank the decision

of the lower court was affirmed, and the Circuit Court of Appeals for the Sixth Circuit, speaking through Judge Sanford, expressly adopted the rule of *In re Oatway:*

> "It is true that in the case of blended moneys in a bank account, consisting in part of trust funds, from which there have been drawings from time to time, it has been held, in favor of the *cestui que* trust, as a presumption of law, that the sums first drawn out were from the moneys which the tort-feasor had a right to expend in his own business, and that the balance which remained included the trust fund, which he had no right to use. *In re* Hallett's Estate, 13 Ch. D. 696, 727; Board of Commissioners v. Strawn, *supra,* at page 51. It is clear, however, in the first place, that this is a mere presumption, which will not stand against evidence to the contrary. Board of Commissioners v. Strawn, *supra,* at page 51.
>
> *"And it is furthermore clear that this rule of presumption has no application where the evidence shows that the first moneys drawn out of the mingled fund by the tort-feasor were not in fact dissipated by him at all, but were merely transferred, in a substituted form, to another fund retained in his own possession. In such case, it must be held that the trust attaches to the substituted form in which the property is retained by the tort-feasor, and that the right to follow the trust in such form is not lost by reason of the fact that the tort-feasor thereafter draws out and spends for his own purposes the balance of the fund in which the trust money was originally mingled. The English case of In re Oatway, L. R. 2, Ch. 356, 359, directly sustains this view* * * *.
>
> "In like manner we are of opinion that in the present case it must be held that the transfer by

> the Ironwood Bank to its own vaults, through the cash draft transactions, of $2807.32, of the balance standing to its credit in the Duluth Bank in which the trust fund had been mingled, did not divest the money thus transferred of its character as a trust fund, but as this money remained thereafter in its own vaults and in its own custody, and subsequently passed into the hands of the receiver as part of the cash assets of the bank, it remained subject in all respects to the trust originally impressed upon the proceeds of the sale of Brennan's stock." (201 Fed. 614, 615.)

Aside from being well reasoned, the case of *Brennan v. Tillinghast* is worthy of careful consideration from this Honorable Court because it is a later decision than any one of the six cases cited by the Security Bank as being most favorable to its position, and, furthermore, each one of the six cases relied upon by the Security Bank was cited and considered by the Sixth Circuit Court of Appeals in arriving at its decision in the *Brennan* case.

The Circuit Court of Appeals for the Second Circuit recently adopted the principle of *In re Oatway* in the case of *Re Pacat Finance Corporation,* 27 F. (2) 810, (1928). Here, trust money deposited with the Pacat Finance Corporation was placed by the Corporation in its own bank account. Pacat then drew on its own bank account to pay for lire to be sent to an Italian bank, which bank received the amount and credited Pacat. N. Bernardini State Bank sought to reclaim from the trustee in bankruptcy of the Pacat Finance Corporation the trust funds from the second commingled fund. From a decree in the lower court in favor of claimant, Pacat appealed. In

affirming the holding of the lower court it was said through Swan, *J*:

> "* * * His contention is that his dollars are traceable into the lire credit which Pacat had with Credito Italiano at the date of the bankruptcy. On December 14th, Pacat drew its check on its account in the National Park Bank to pay for 1,000,000 lire to be sent to Credito Italiano through the Banca D'Italia. This sum was received by Credito Italiano and credited to Pacat. On December 15th and 16th Pacat again drew checks which purchased 2,000,000 lire that were deposited to its credit with Credito Italiano. *While Berardini's dollars cannot literally be traced into any of these lire credits, the applicable principle is that stated by Joyce, J., in In re Oatway,* * * *.
>
> "* * * *It is, in my opinion, equally clear that when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, the rest of the balance having been afterwards dissipated by him, he cannot maintain that the investment which remains represents his own money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust.*"

Accord: Brennan v. Tillinghast, 201 F. 609, 614 (C. C. A. 6); Primeau v. Granfield, 184 F. 480, 484 C. C. S. D. N. Y.); *In re* A. O. Brown & Co., 189 F. 432, 439 (D. C. S. D. N. Y.); City of Lincoln v. Morrison, 64 Neb. 822, 90 N. W. 905, 57 L. R. A. 885.

"Consequently the lire credits created by withdrawals from the National Park Bank, when Pacat's account therein was composed in part of Berardini's

> checks received and held by Pacat on constructive trust, were in equity subject to a lien or charge in favor of Berardini. * * *" (27 Fed. (2), 813, 814.)

Even the most casual reading of the opinions in the cases of *Brennan v. Tillinghast, supra,* and *re Pacat Finance Corporation, supra,* reveals that, without a doubt, the principle of *In re Oatway* is law in the Federal courts. The brief for the Security Bank attempts to distinguish those cases upon the ground that there the commingled fund was merely transferred from one fund to another, that is, *"the money still remained money"* (Brief for Security Bank at page 60); whereas, in the present case and the *Oatway* case a portion of the commingled fund was converted *from money into property.*

It is submitted that the distinction attempted to be drawn by the Security Bank is not only unfounded in authority,

> *Primeau v. Granfield,* 184 Fed. 480 (mixed fund converted into real estate, and lien allowed).

See:

> *In re A. O. Brown & Co.,* 189 Fed. 432 (mixed fund converted into stock, and lien allowed),

but also does violence to an elementary principle of equity. Mr. Justice Dewey, while holding for the *cestui* in a case analogous to the present one, summarized the applicable equitable principle:

> "* * * There is a general equitable rule that, where a wrongdoer knowingly mingles the property of another with his own in such a manner as it becomes indistinguishable, the true owner may claim

> the whole mass, or, if it has been disposed of, *may follow it or its proceeds as the case may be*, as long as he can trace them for the purpose of fastening an equitable lien upon the property of which he has been dispossessed." (*Fiman v. State of South Dakota,* 29 Fed. (2) 776, 780, C. C. A. 8 (1928), cert. den. 73 L. ed. 987.

The equity of the wronged *cestui* is equally as great in the case where a portion of the commingled money is converted from money into property, as it is in the situation where a portion of the mingled monies is transferred from one fund to another fund and retained in the form of money. It is absurd to declare that the *cestui's* lien is to be allowed "where the money remains money" and is not to be allowed in the case where the money is converted into a potato.

The brief for the Security Bank contends that the United States Supreme Court has expressly repudiated the doctrine of *In re Oatway*. In support of this contention are cited the cases of *Peters v. Bain*, 133 U. S. 670, 33 L. ed. 696 (1889), and *Schuyler v. Littlefield,* 232 U. S. 707, 58 L. ed. 806 (1913).

The proper basis for the Supreme Court's refusal in the case of *Peters v. Bain* to allow the *cestui* a preferred claim is not because it was opposed to the principle later set forth in the case of *In re Oatway,* but because the proper foundation for the application of the *In re Oatway* principle was not laid by the *cestui* in the *Peters v. Bain* case. In the principle case, there is absolutely no doubt whatever that a portion of the *mixed* fund was utilized by Richfield for the purchase of the property upon which Universal claims a lein. In *Peters v. Bain* the *cestui* was unable to prove that a portion of the *mixed* fund went

toward the purchase of the property. That this is the proper distinction between *Peters v. Bain* and the present case is seen from the following quotation from the opinion of Mr. Justice Waite rendered when the case was before the Circuit Court of Appeals:

> "The property in the second class, however, occupies a different position. *There the purchases were made with moneys that cannot be identified as belonging to the bank. The payments were all, so far as now appears, from the general fund then in the possession and under the control of the firm.* SOME OF THE MONEY OF THE BANK MAY HAVE GONE INTO THIS FUND." (33 L. ed. at 699.)

This distinction is further supported by the following statement of Mr. Chief Justice Fuller in speaking for the Supreme Court:

> "It was said by Mr. Justice Bradley in Frelinhuysen v. Nugent, 34 Fed. Rep. 229, 239; 'Formerly the equitable right of following misapplied money or other property in the hands of the parties receiving it depended upon the ability of identifying it; the equity attaching only to the very property misapplied. This right was first extended to the proceeds of the property, namely, to that which was procured in place of it by exchange, purchase or sale. But if it became confused with other property of the same kind, so as not to be distinguishable, without any fault on the part of the possessor, the equity was lost. Finally, however, it has been held as the better doctrine that confusion does not destroy the equity entirely, but converts it into a charge upon the entire mass, giving to the party injured by the unlawful diversion a priority of right over the other creditors of the possessor. This is as far as the rule has been

carried. The difficulty of sustaining the claim in the present case is, that *it does not appear that the goods claimed*,—that is to say, the stock on hand, finished and unfinished—*were either in whole or in part the proceeds of any money unlawfully abstracted from the bank.*' THE SAME DIFFICULTY PRESENTS ITSELF HERE, and while the rule laid down by Mr. Justice Bradley has been recognized and applied by this court, National Bank v. Insurance Company, 104 U. S. 54, 67, and cases cited, yet, as stated by the Chief Justice, 'purchases made and paid for out of the general mass cannot be claimed by the bank unless it is shown that its own moneys then in the fund were appropriated for that purpose.' And this the evidence fails to establish as to any other property than that designated in the decree * * *." (33 L. ed. at 704.)

Schuyler v. Littlefield, 232 U. S. 707, 58 L. ed. 806 (1913), the case in which the United States Supreme Court for the second time supposedly refused to adopt the rule of *In re Oatway,* is distinguished from the principal case and *In re Oatway* upon the same grounds as *Peters v. Bain.* The statement of the Supreme Court in the *Schuyler* case:

> "But the record fails to show when the $266,600 was deposited, and it also fails to show with the requisite certainty the particular use made by Brown & Company of that money." (58 L. ed. at 808.)

as well as the following language found in the opinion in the Circuit Court of Appeals:

> "As we have seen, the Hanover Bank had in its possession various surpluses of collaterals above the amount of the several notes for which such collateral was pledged, some of these collaterals were paid for

> by checks drawn on the Hanover Bank and paid on the 24th, and it is contended that a lien for the trust funds is established against the surpluses of collaterals so purchased. *But there is nothing to trace claimant's money into any particular stocks or bonds, or into the collateral put up against any particular loan.* * * *
>
> "The same court which decided Smith v. Mottley, however, subsequently held, in Board of Commissioners v. Strawn, 157 Fed. 49, 84 C. C. A. 553, 15 L. R. A. (N. S.) 1100, that *the mere fact that the misuse of a trust fund has gone to swell, in one form or another, the general assets of a bankrupt, is not enough to charge a lien on such assets; and that, to impress a trust upon the property of a tort-feasor* who has used the trust fund in his private affairs, *it must be traced in its original shape or substituted form.*" (*In re A. O. Brown,* 193 F. 24, 28, 29 (C. C. A. 2) (1912).)

clearly indicates that the mixed fund may have been completely exhausted before any part of the bankrupt account was converted into property. Obviously in such a case no one would contend that the principle of *In re Oatway* was applicable.

As conclusive evidence of the fact that neither *Peters v. Bain* nor *Schuyler v. Littlefield* settle the rule in the Federal courts as being contrary to the principle of *In re Oatway,* we call the attention of this Honorable Court to the fact that in none of the cases decided after those two cases (cited either in the brief for the Security Bank or brought to light by our research) did the courts feel that the *Peters v. Bain* or the *Schuyler* case settled the rule to be applied to facts similar to those with which we are here concerned.

There remain to be considered three other cases which are often cited in support of the proposition that the doctrine of *In re Oatway* is not applied in the Federal Courts.

Board of Commissioners v. Strawn, 157 Fed. 49 (C. C. A. 6th) (1907);

Empire State Surety Co. v. Carroll, 194 Fed. 593 (C. C. A. 8th) (1912);

In re City Bank of Dowagiac, 186 Fed. 413 (D. C. Michigan) (1910).

It is submitted that a careful reading of the opinion in each of these cases will reveal that the manner in which we have distinguished *Peters v. Bain* is equally applicable to each of them. Furthermore, it is interesting to note that *Brennan v. Tillinghast, supra,* a later case than the *Strawn* case, but arising in the same Circuit Court of Appeals held squarely in favor of the view urged by Universal in this controversy. The *Empire State Surety* case, *supra,* which arose in the Eighth Circuit Court of Appeals, is controlled by the case of *Fiman v. State of South Dakota, supra,* a later decision in the same Circuit holding squarely in our favor. The *Dowagiac* case arising in a Michigan District Court, is obviously controlled by *Brennen v. Tillinghast,* the latest decision upon our facts in the Sixth Circuit.

Board of Commissioners v. Strawn, supra, is of interest in that it not only serves to bear out the distinction between *Peters v. Bain* on the one hand, and the present case and the *Oatway* doctrine in the other, but it cites *Peters v. Bain* for the proposition which it really holds; namely, that where the *cestui* could not prove that a part of the MIXED FUND had been converted into property, then

he would not be allowed a lien. In the *Strawn* case, the court said:

> *"The assumption that all of these bills and notes were bought and paid for by the actual application of the money in the vaults of the bank with which the trust fund money has been mingled, or for loans made out of that fund, is not borne out by the evidence. Some of the transactions did not involve the actual payment of any money out of the funds of the bank, inasmuch as the proceeds would be passed to the credit of the party procuring the discount. In some cases the credit thus obtained was possibly drawn upon afterwards. The bank officers were unable to point out a single piece of this commercial paper in the receiver's possession as having been acquired by the actual use of the blended money of the bank and the county."* (157 Fed. at 53.)

> *"Without going more into detail, it is enough to say that the evidence does not satify us that all or any large part of this mass of paper was acquired by the use of the moneys of the bank with which this trust fund had been mingled . . .* But aside from this view of the evidence, the claim to a general charge upon any and all property acquired by the bank, through the use of the general funds of the bank with which this trust fund had been blended, is not supported by the weight of authority, nor do the cases decided by this court go so far. *That the misuse of this trust fund has gone to swell in one form or another, the general assets of the bank is not enough to charge the whole with a lien, will not be seriously contested. The cases which deny such a contention are numerous."* (157 Fed. at 54.)

> *"Peters v. Bain,* 133 U. S. 671, 678, 693, 10 Sup. Ct. 354, 33 L. Ed. 696, is a very close authority

> upon the facts of this case. * * * It was sought, also, to impress a lien upon other property which has been *'paid for by the firm out of the general mass of moneys in their possession, and which may or may not have been made up in part of what had been wrongfully taken from the bank.'"* (157 Fed. at 55.)

If the presumption established in *Knatchbull v. Hallett,* L. R. 13 Chancery Division, 696 (Court of Appeal) (1880), and adopted by the Federal Courts, *Central Natl. Bank v. Conn. Mut. Life Ins.,* 14 U. S. 54, 26 L. ed. 693, is carried to its logical extreme, it is obvious that in a factual situation such as that presented in our case, the *cestui* would not be entitled to a lien upon the property purchased with a portion of the mixed funds. However, this presumption, if it be a presumption, was adopted by the court in *Hallett's* case for the benefit of the *cestui* as against a wrongdoing trustee. It was never intended to be invoked for the purpose of defeating the rights of the innocent beneficiary and protecting the wrongdoing trustee.

This view has been adopted by the well reasoned authorities upon this matter:

Primeau v. Granfield, supra;

Brennan v. Tillinghast, supra;

In Re Pacat Finance Corporation, supra;

and in 27 *Harvard Law Review,* 125, 129, we find the following statement by Professor Austin Wakeman Scott:

> "This is, of course, a pure fiction, and, as usually happens when a proper result is reached by fictitious reasoning, has led to erroneous results in other cases. It seems to be thought necessary to show in what

> part of the commingled fund the claimant's money is to be found; and as it is impossible actually to distinguish the claimant's contribution, the courts have resorted to a presumption as to the intent of the wrongdoer, although there is no reason to suppose that he had any particular intent, and no reason for allowing his intent to affect the claimant's rights. *The claimant ought . . . to have an interest in what is left, not because of any intent of the wrongdoer, but because the wrongdoer, whatever his intent, should not be allowed, by taking away a part of the fund, to deprive the claimant of his lien on, or share of, the rest of the fund.*"

Although we recognize that the decisions of the California state courts upon our question are not absolutely controlling in an action in the Federal Courts:

> "Moreover, in a federal court of equity, we must decide cases in accordance with our view of the general principles of equity jurisprudence. Kuhn v. Fairmont Coal Co., 215 U. S. 349, 363, 30 S. Ct. 140, 54 L. Ed. 228; Russell v. Southard, 12 How. 139, 13 L. Ed. 927; Neves v. Scott, 13 How. 268, 14 L. Ed. 140. The decisions of the particular state in which the cause of action arose are to be followed only in so far as they conform to established principles of equitable jurisprudence." (*Elmer v. Kemp,* 67 Fed. 2d 948, 952 (C. C. A. 9) (1933).)

we take the liberty of calling to the attention of this Honorable Court the well reasoned opinion of the California Supreme Court in *Mitchell v. Dunn,* 211 Cal. 129 (1930).

There the California court reached the same result as did the English court in *Re Oatway* and Mr. Chief Justice Waste, in speaking for the California Supreme Court, said:

> "The only question left to determine was whether the sum withdrawn was from the trust funds or from the personal funds of appellant. If the presumption that withdrawals must be deemed to have been from the personal part of the commingled fund applies to such a case, it is clear that no trust can be enforced against the Jefferson Street property.
>
> "We are of the opinion that the presumption mentioned has no application to a case such as this. The presumption is nothing more than a fiction created to assist the *cestui,* not to injure him. It was created to assist *cestuis* in following the trust property, not to hinder them. The basis of the presumption is that it will be presumed that a trustee acts honestly, and not dishonestly." (211 Cal. at 134.)
>
> "The appellant herein wrongfully dissipated the trust funds in her possession and then replaced the funds wrongfully taken. Then, after purchasing the real property herein involved, appellant dissipated the entire fund. Can appellant, after having been guilty of such conduct over a period of years, come before the court and contend that, because it must be presumed she acted rightfully on November 3, 1934, the only tangible property purchased from the fund and still remaining in her possession must be presumed to have been purchased with personal funds, and that

all the money that was dissipated by her must be presumed to have been trust funds? To state the proposition is to refute it. In fact, if we are to presume the appellant acted rightfully, it would be far more consonant with such a presumption to say that the property purchased was purchased with trust funds, and the money dissipated was personal funds. At any rate, the presumption in reference to withdrawals, in a contest between the *cestui* and trustee, based as it is, on a theory of right-doing, cannot be indulged in to defeat the *cestui's* right of recovery when all the evidence shows a consistent course of conduct amounting to wrong-doing. To permit the presumption to be used for that purpose would be to permit its use as a shield for wrong-doing, and that we are not inclined to do." (211 Cal. at 135.)

Although the language of some of the Federal decisions ostensibly tends to support a contrary rule, it is respectfully submitted that a careful scrutiny of the facts and holding in such cases indicates, either that no part of the mixed fund actually went into the purchase of the property sought to be impressed with a lien, or at most, that the decision was based upon a hasty and ill considered application of the so-called presumption established in *Hallett's* case. We feel that in those Federal cases presenting the *actual factual setup confronting us in the case at bar,* that it is evident that the English rule as set forth in *Re Oatway* has been adopted by, and is, the rule in the Federal courts.

Conclusion.

In conclusion, may we again direct the attention of this Honorable Court to the fact that the method of obtaining the lowest bank balance, adopted by the Special Master, has resolved all doubt in favor of the wrongdoer Richfield and the trustee of its bond indenture, Security Bank, at the expense of the innocent minority stockholders of Universal.

We believe an examination of the record discloses that there is absolutely no evidence to support the Master's theory and our research, and apparently the resarch of other counsel, does not disclose any cases which support that theory. There are, however, definite statements in the cases as to the burden of proof in matters of this kind. That burden, we confidently believe, was maintained by Universal when the daily closing bank balances were shown. The evidence of posted balances certainly cannot be considered as refuting that *prima facie* case.

With respect to the argument of Security Bank, that this Honorable Court should not allow Universal to trace its stolen moneys out of the Richfield bank account into properties purchased therewith, we submit that not only the adoption of the rule of *in re Oatway* by the Federal Courts, but every consideration of justice and equity requires that the conclusion of the Special Master and the learned Trial Court upon this point be confirmed.

Respectfully submitted,

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